



**MONITORING COUNTRY PROGRESS
IN CENTRAL AND EASTERN EUROPE
& EURASIA**

**USAID/E&E/PO
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Summary

Introduction

This paper presents USAID/E&E's system for monitoring country progress in the twenty-seven transition country region of Eastern Europe and the former Soviet Union. These countries are those which have received assistance under the SEED and FSA Acts.¹ As in past *Monitoring Country Progress (MCP)* reports, transition progress is tracked along four primary dimensions: (1) economic reforms; (2) democratization; (3) economic performance (which includes economic structure and macroeconomic conditions); and (4) human capital (or social conditions). An important objective of this report and the *MCP* system is to provide criteria for graduation or phase-out of transition countries from U.S. Government assistance, and to provide guidelines in optimizing the allocation of USG resources in the region.²

Findings

Economic Reforms. First stage economic reforms are complete or close to being complete in the large majority of transition countries. First stage reforms focus on liberalizing the economy from government intervention and ownership. Virtually all the transition countries are much farther behind in second stage reforms than first stage reforms, and much farther behind standards in advanced industrial economies. Second stage economic reforms concentrate in large part on building a government's institutional capacity to govern, through reforms in the financial sector, infrastructure, and economic governance. In general, the most progress in second stage reforms has been made in banking reforms. The least progress has occurred in competition policy followed by non-bank financial institutions, and infrastructure reform.

Good progress was made in economic reforms in 2004 across much of the region. Fifteen of the twenty-seven countries advanced in at least one dimension of second stage reforms. Seven countries made gains in 2004 in first stage reforms. No country regressed in either stage reforms in 2004. The greatest gains occurred in the Southern Tier CEE countries, and particularly in the three Southern Tier CEE leaders (Croatia, Bulgaria, and Romania), where the pull of EU accession has been the strongest.

The Northern Tier CEE countries are well out front and have remained well out front of the rest of the countries in progress in economic reforms since the transition began. Nevertheless, the Southern Tier CEE countries have been slowly closing the gap vis-à-vis the Northern Tier CEE countries (since perhaps 1999). The Eurasian countries, in contrast, do not seem to be closing the economic reform gap.

¹ Eight of the 27 countries have graduated from USG (SEED Act) assistance. These are the Northern Tier Central and Eastern Europe (CEE) countries of Estonia (which graduated in 1996), the Czech Republic and Slovenia (in 1997), Latvia and Hungary (in 1999), and Slovakia, Lithuania, and Poland (in 2000).

² An application of the *MCP* system to phase-out decisions is provided in *Appendix 3*. This process took place in the spring 2004 with overall supervision from and collaboration with the State Department's Office of the Coordinator for the U.S. Assistance for Europe and Eurasia (EUR/ACE).

Democratization. The Northern Tier CEE countries are much more advanced on democratic reforms (across all sub-sectors) than are the rest of the transition countries. The Eurasian countries lag the most. The range in progress in democratization across the transition countries spans the range of possibilities worldwide. By Freedom House measures, democratic reform progress in six Northern Tier CEE countries is comparable to EU standards. Turkmenistan, in contrast, is characterized by an absence of democratic freedoms and distinguished by receiving Freedom House's worst possible score worldwide, a distinction shared by only seven other countries: Burma; Cuba; North Korea; Libya; Saudi Arabia; Sudan; and Syria.

The 2004 democratization trends are largely a continuation of a pattern of a widening democratization gap between CEE and Eurasia that emerged as early as the early 1990s. Most of the advances in 2004 occurred in CEE (six of eight countries that moved forward were in CEE) and most of the backsliding occurred in Eurasia (three of five countries that regressed were in Eurasia). The 2004 exceptions to the growing CEE-Eurasia democratization gap on the CEE side were Lithuania and Romania. In Eurasia, only two countries advanced in democratic freedoms in 2004: Ukraine and Georgia.

Economic and democratic reforms combined. *Summary Figure 1* provides an overall picture of the status of the economic and democratic reforms in the transition countries in 2004. These data show that progress in economic and democratic reforms in the transition region varies greatly, ranging from that found in Hungary, Estonia, and Poland at one end of the reform spectrum to Turkmenistan, Belarus, and Uzbekistan at the other end. The three primary sub-regions have relatively distinct reform profiles, particularly in terms of progress in democratization: that is, all the Northern Tier CEE countries are farther along in democratization than the rest; and all the Southern Tier CEE countries (except the province of Kosovo) are farther along in democratic reforms than all the Eurasian countries. In addition, the cohesiveness or homogeneity of these reform profiles differ among the three sub-regions: the Northern Tier CEE countries are much more clustered (i.e., have a relatively homogeneous reform profile), while the Eurasian countries are much more dispersed than either of the two CEE sub-regions.

Economic Performance. Overall, macro-economic performance in recent years has been impressive in a large majority of the transition economies. By most economic performance measures, the Northern Tier CEE countries continue to outperform the rest of the transition countries.

Since 2000, the transition region as a whole has witnessed annual economic growth rates of roughly 5% or higher. These rates (from 2000-2004) have exceeded the global economic growth rates. Economic growth has been particularly high in Eurasia, averaging about 8% in 2003-2004.

Impressive economic growth has been accompanied by generally impressive strides towards macro-economic stability in most of the transition countries. Inflation rates are

now single-digit in all but a handful of economies in the region. With a few exceptions, external debt is manageable, if not low.

Virtually all the transition countries have seen very significant increases in the private sector share of GDP since the collapse of communism. Private sector shares are largest in the Northern Tier CEE countries (76% in 2004), though most other transition countries have private sector shares that are approaching this level.

The composition of these private sectors appears to vary widely across the region. The SME sectors in the CEE countries are much larger than those in Eurasia. Roughly 45% of employment in the Northern Tier CEE countries comes from SMEs. This compares to 37% in the Southern Tier CEE countries and only 12% in Eurasia.³ A larger SME sector allows for more broad-based and hence sustainable economic growth.

Export shares of GDP are much larger in the Northern Tier CEE countries than elsewhere in the transition region; at least twice as large on average as compared to the Southern Tier CEE countries and Eurasia by one measure. Outward-orientation has increased significantly in CEE since 1990. The trend is ambiguous in the case of Eurasia.

Cumulative foreign direct investment per capita continues to be far and away much higher in the Northern Tier CEE countries than elsewhere in the transition region: total cumulative FDI per capita in the Northern Tier CEE is more than three times the amount in the Southern Tier CEE and closer to six times the volume in Eurasia.

Human capital.

a. Evidence of some improvement in social conditions. Available evidence suggests that the resumption of economic growth in the transition region has had some favorable effects on some social conditions. Poverty rates have fallen as economic growth has resumed. Real wages have bottomed out in all of the transition economies and have been increasing for some years now.

Infant mortality rates (IMRs) are lower today than at the outset of the transition in a large majority of transition countries. In the Northern Tier CEE countries, these rates have been almost halved since 1990: from 15 deaths per 1,000 live births in 1990 to 8 deaths in 2002. In the Southern Tier CEE, the drop has been from 21 deaths in 1990 to 16 deaths in 2002. While infant mortality rates are much higher in some of the poorer Eurasian countries, the trend of declining IMRs generally holds in Eurasia as well as in CEE. Nine of the twelve Eurasian countries had lower IMRs in 2002 as compared to 1990.

The deterioration in secondary school enrollments has been greatest in Eurasia. In 2002, secondary school enrollment rates were 89% in the Northern Tier CEE, 71% in the Southern Tier CEE, and only 51% in Eurasia. However, for most countries, these enrollment trends appear to have reached a minimum in earlier years. For all the CEE

³ These data come primarily from a World Bank dataset of SMEs' worldwide, and come with a significant lag as well as likely measurement errors or inconsistencies. A key priority for the next MCP report is to update and build on this dataset.

countries for which data are available (except Croatia), secondary school enrollment rates have been rising since at least 1995. Eurasian trends are much more mixed. At least one half of the Eurasian countries have been experiencing a rise in secondary school enrollments in recent years. However, in the case of six countries, the trends in recent years are ambiguous as to whether enrollments have bottomed out (in the case of Moldova, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, and Turkmenistan).

b. Evidence of a growing health gap. Despite largely favorable macroeconomic trends across the three transition sub-regions, and a turnaround in some social conditions in most countries (as noted above), there are not yet signs of improvement in some key health trends in much of the former Soviet Union.

After an initial and slight decline in life expectancy in the CEE countries, life expectancy has been increasing, since 1994-1995. Twelve of thirteen CEE countries had life expectancies higher in 2002 than in 1989. In contrast, life expectancy in Eurasia fell much more drastically early on in the transition to 1994, recovered some through 1998 and since then, has fallen more to a new low. Nine of twelve Eurasian countries had life expectancies lower in 2002 than in 1989.

The rate of increase in the incidences of HIV and TB in some countries in the transition region is very high. Compared to only a slight increase in the percent of the population with HIV in EU-15⁴ from 1997 to 2003, increases in Ukraine, Estonia, Russia, and Latvia, in particular, have been very large.

All nine of the transition countries which witnessed a decrease in tuberculosis incidences from 1989 to 2002 are CEE countries; all the countries of the former Soviet Union (i.e. the Eurasian countries plus the Baltics), as well as Bulgaria and Romania have witnessed an increase in TB. TB incidence is highest and has increased the most in Kazakhstan, Kyrgyzstan, Romania, Georgia, and Russia.

The lion's share of deaths has been due to non-communicable diseases in the transition region, mostly due to poor diet and lack of exercise, and excess smoking and alcohol. Of the transition region, countries of the northern Former Soviet Union had the highest proportion of deaths attributed to these "lifestyle diseases" in 2000: 57%.⁵ This compares to 40% in the EU-15. "Non-medical" deaths are also relatively high in the northern Former Soviet Union. These deaths include suicides and homicides, and perhaps can also be indirectly tied to lifestyle issues.

In some of the countries of the northern Former Soviet Union, the life expectancy gender gap (i.e., the number of years that females out live males) is among the highest worldwide. Overall, 45% of males in transition countries smoke, yet only 16% of females smoke.

⁴ The EU-15 consists of the original 15 countries of the European Union.

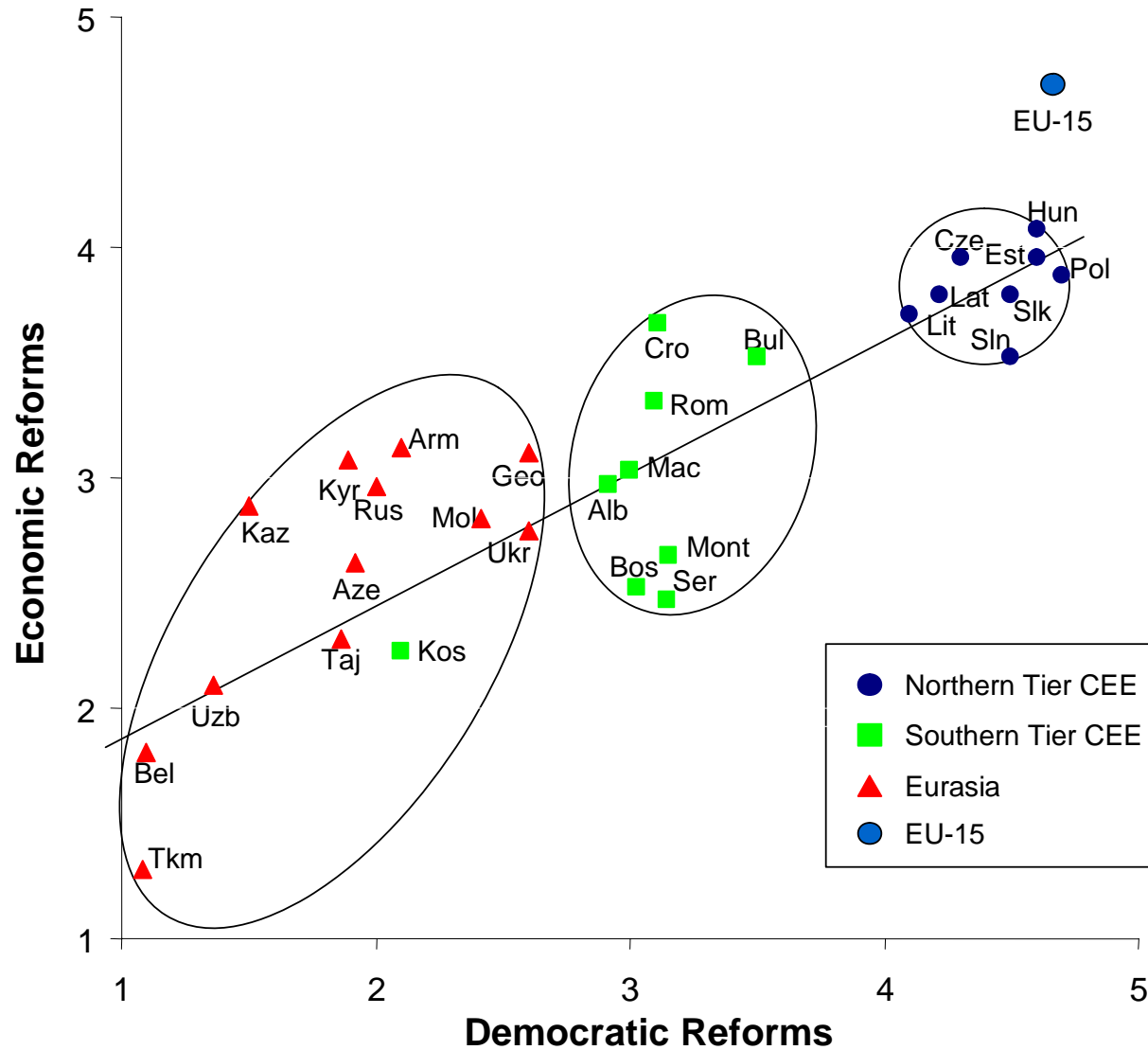
⁵ The northern Former Soviet Union countries are Russia, Ukraine, Moldova, Lithuania, Latvia, and Estonia.

Economic performance and human capital combined. *Summary Figure 2* provides an overall picture of the status of economic performance and human capital in the transition countries in 2002-2004 (most recent data available). Overall, it shows a picture that is quite similar to that of *Summary Figure 1* of economic and democratic reforms. In particular, the Northern Tier CEE countries are out front on both dimensions (and relatively more clustered or homogenous as a sub-region than the other two); the Eurasian countries generally lag the most on both dimensions of the three sub-regions. In contrast to the reform picture, however, there is much more overlap in performance between the three sub-regions in terms of economic performance and human capital. Croatia, for example, has a human capital profile comparable to the Northern Tier CEE, and Albania's is closer to Eurasian human capital standards. Belarus' human capital profile more closely resembles CEE norms. Bosnia-Herzegovina's economic performance ranks among the poorest Eurasian performers; Azerbaijan's is comparable to the Southern Tier CEE norms.

In general, this overlapping picture more closely resembles the economic and democratic reform chart of the late 1990s. One might expect that indicators of macro-economic performance and human capital would change with a lag as a result of changes in economic and democratic reforms. Hence, "today's" reform picture may more closely resemble "tomorrow's" economic performance and human capital picture.

Summary Figure 1

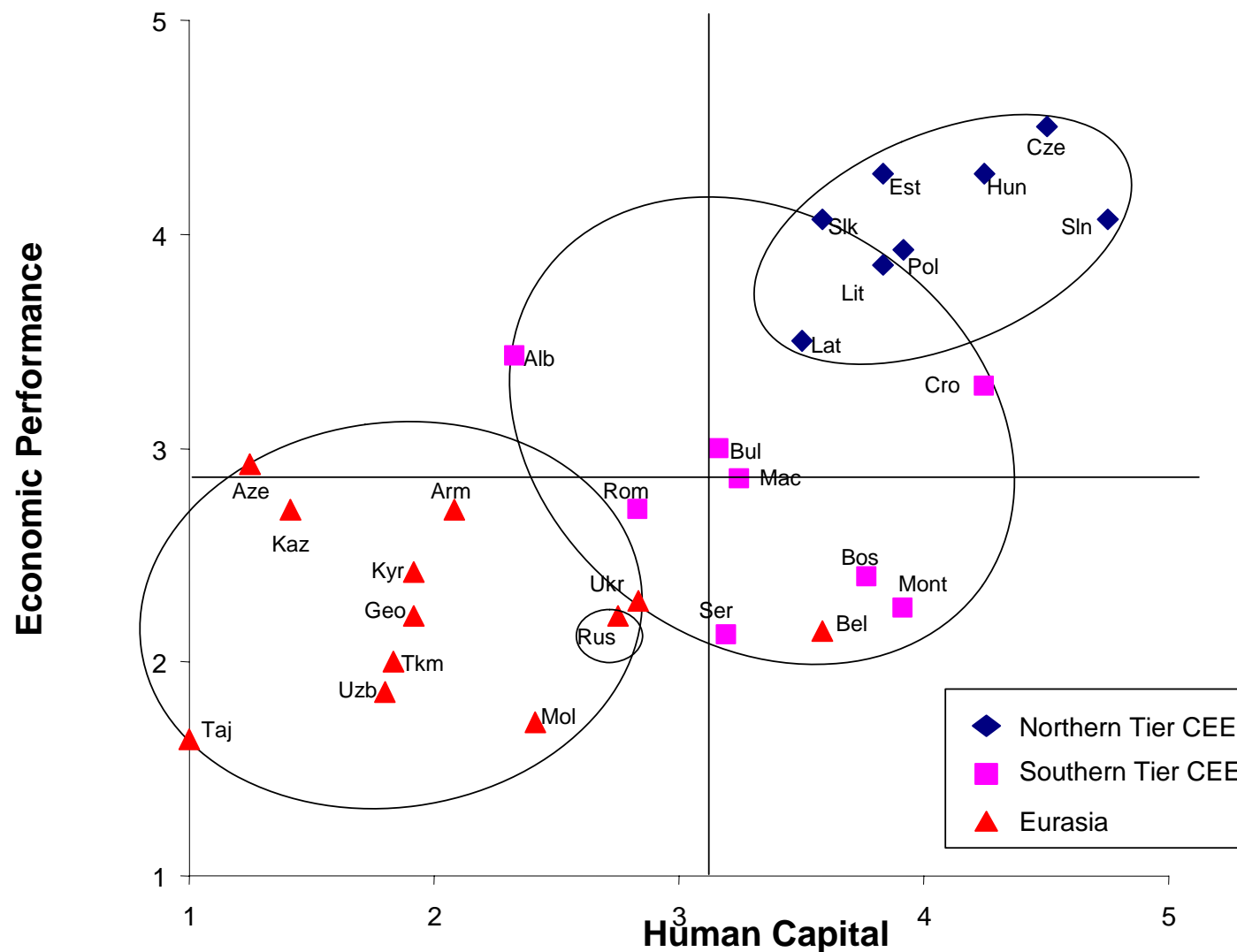
Economic and Democratic Reforms in 2004



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID drawing from Freedom House, *Nations in Transit 2004* (2004), and EBRD, *Transition Report 2004* (November 2004).

Summary Figure 2

Economic Performance and Human Capital in 2002-2004



USAID, MCP#9 (2005) drawing from World Bank, *World Development Indicators 2004* (2004); UNICEF, *Social Monitor 2004* (2004); EBRD, *Transition Report* (November 2004); Ayyagari, Beck, and Demircuc-Kunt, *Small and Medium Enterprises across the Globe: A New Database*, World Bank Policy Research Working Paper 3127, (August 2003).